No. 02-1543

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Supreme Court of the United States

UNISYS CORPORATION,
Petitioner,

v.

COMMONWEALTH OF PENNSYLVANIA,
BOARD OF FINANCE AND REVENUE,
Respondent.

On Petition for Writ of Certiorari To The Supreme Court of Pennsylvania

BRIEF OF *AMICI CURIAE* COUNCIL ON STATE TAXATION AND PENNSYLVANIA CHAMBER OF BUSINESS AND INDUSTRY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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SUMMARY OF THE ISSUE

The Council On State Taxation and The Pennsylvania Chamber Of Business And Industry ask this Court to accept this case for review in order to clarify the scope of the "fair apportionment" requirement for state taxes. It is the amici's position that the fair apportionment requirement of the Due Process[1] and Commerce Clauses[2] of the United States

[1] [N]or shall any state deprive any person of . . . property, without due process of law". U.S. CONST. Amend XIV, § 1.

[2] "The Congress shall have power . . . [t]o regulate commerce . . . among the several states". U.S. CONST. Art. I, § 8, cl. 3.

Constitution prohibits a State from using a tax base calculated using one business grouping while dividing that base among the taxing states using another business grouping. Unfortunately, this is exactly what Pennsylvania does by defining its tax base to include values from *both* the taxpayer *and* the taxpayer's subsidiaries, and then dividing that tax base among the taxing states using *only* the taxpayer's (and not the subsidiaries') values. Pennsylvania's business tax system therefore violates the fundamental constitutional concept of fair apportionment.

The Pennsylvania Supreme Court failed to find Pennsylvania's system unconstitutional because of the court's self-admitted confusion over this Court's standards for determining when a tax is fairly apportioned. This case raises the pressing questions of what standard is used to determine the constitutional fairness of a state business activity tax system and whether a state that calculates a tax base on a unitary premise must also calculate the division of such base on the same premise. This case therefore presents an explicit opportunity for this Court to remedy the confusion raised by the Pennsylvania Supreme Court and to prevent other injustices imposed by similar tax systems.

INTEREST OF THE *AMICI CURIAE*

The Council On State Taxation (COST) and The Pennsylvania Chamber Of Business And Industry (Chamber) submit this brief as amici curiae in support of Petitioner in the above-captioned matter.[3]

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[3] No counsel for a party authored this brief in whole or in part, and no person or entity, other than *amici curiae*, has made a monetary contribution to the preparation or submission of this brief. Written consents for the filing of this brief have been obtained from the Petitioner and Respondent and filed with the Clerk of the Court.

COST [4] is a non-profit trade association organized in 1969 as an advisory committee to the Council of State Chambers of Commerce. COST, which was separately incorporated on January 1, 1992, has a membership of over 560 of the nation's largest multistate corporations involved in interstate and international commerce. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of its members and all multi-jurisdictional business entities.

Most of COST's members are engaged in business in the Commonwealth of Pennsylvania and thus are subject to Pennsylvania's unconstitutional calculation if its franchise tax. Thus, these members have a particular interest in this case. Further, all of COST's members are subject to a variety of state taxes that may suffer today or in the future from similar defects. These members have a continuing interest in the availability of a clear and consistent definition of the fair apportionment requirement. COST and its members have consistently asked this Court for further guidance on this issue in the appropriate case. *See e.g., Caterpillar v. The New Hampshire Department of Revenue Administration*, Brief of Amicus Curiae in Support of Pet. for Cert., No. 99-1214 (03/08/00). Therefore, COST and all of its members have an interest in this case and their knowledge can add to the discussion of the issue.

The Chamber is a non-profit corporation devoted to representing the interests of the business community throughout the Commonwealth of Pennsylvania. The Chamber has over 10,000 member corporations, trade associations and local chambers of commerce. The Chambers' members employ more than half of the private workforce in Penn-

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[4] COST was previously the Committee On State Taxation but changed its name to the Council On State Taxation by vote of its membership November 6, 2001.

sylvania. The Chamber strives to provide a competitive business climate for all Pennsylvania companies in an effort to create and maintain jobs in the Commonwealth. Government laws, regulations, and policies that impose undue burdens and additional regulatory requirements on employers dramatically increase the cost of doing business in Pennsylvania and lessen their ability to compete.

The Chamber notes that Pennsylvania is in the midst of a fitful recovery from a sudden recession that hit in late 2000. Like most states, Pennsylvania is faced with higher unemployment rates and enormous budget deficits. To compound an already challenging economic reality, Pennsylvania ranked 47th out of the 50 states in job creation between the years 1992 and 2002. Such a performance during a period of unprecedented growth in the nation places Pennsylvania behind the eight ball in economic recovery. The Chamber and its members find that judicial decisions related to the state's tax climate are often looked to as companies make decisions on whether to expand or locate in the state and it is incumbent upon the courts to assess all of the ramifications of any decision.

OVERVIEW OF STATE BUSINESS ACTIVITY TAX CALCULATION

Every state is allowed to tax only the values of a corporation that are reasonably related to the activity in the state. This concept is embedded in the "fair apportionment" prong of the Due Process and Commerce Clauses' protections. *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977). Unlike the federal government that uses a concept of formal separate geographic or transactional accounting to determine the appropriate taxing jurisdiction and thus the fair apportionment of tax at the international level, each state has adopted a form of formulary apportionment to calculate its share of the business activity tax base of a multistate entity.

Formulary apportionment "rejects geographical or transactional accounting, and instead calculates the local tax base by first defining the scope of the 'unitary business' of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that 'unitary business' between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account object measures of the corporation's activities within and without the jurisdiction." *Container Corp. v. FTB*, 463 U.S. 159, 165 (1983). Formulary apportionment is hence a two-step process. First, a taxpayer calculates its total tax base on a nationwide (and infrequently a worldwide) level. Second, the taxpayer divides that total base among the states according to a statutory formula. That formula varies state by state but typically uses some combination of the ratio of the taxpayer's property, payroll and/or sales in the state to those factors everywhere. Formulary apportionment applies to business activity taxes in every state regardless of the chosen tax base (income, gross receipts, net worth, *etc.*)

In this case, Pennsylvania chose to adopt a tax that sought to tax a business's "value." This tax base includes both the taxpayer's net worth and capitalized income *and* the net worth of the taxpayer's subsidiaries.[5] However, the factors used by Pennsylvania to apportion the taxpayer's total tax

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[5] The Pennsylvania tax base is significantly more complicated than this summary and is fully explained in the Taxpayer's Petition at pp. 3-4. The Taxpayer's case also raises the question as to whether including the taxpayer's dividends received from its subsidiaries in the calculation of its capitalized income without also including the subsidiaries' apportionment factors related to those dividends violates the Due Process and Commerce Clauses. The argument regarding including the dividends from subsidiaries in the tax base calculation—but not the factors generating the income in the apportionment formula—is essentially the same as the argument regarding including the net worth of the subsidiaries in the tax base but not the factors that generated that net worth, and will not be separately stated here.

base between Pennsylvania and all other states where the taxpayer is doing business reflects only the taxpayer's factors, not those related to its subsidiaries. Thus, the subsidiaries' value is included in the tax base but not in the apportionment formula.

REASONS FOR GRANTING THE PETITION

I. THIS COURT IS THE ONLY COURT THAT CAN PROVIDE A NATIONAL, UNIFORM DEFINITION OF THE SCOPE OF THE CONCEPT OF "FAIR APPORTIONMENT".

This Court has declined several times in the past[6] to further expound on the appropriate scope of "fair apportionment" and with time it has become apparent that further exposition is in fact necessary due to states' admitted confusion over the concept. The highest court in Pennsylvania in its own decision in this case has noted that "the [U.S.] Supreme Court has not fully developed the contours of permissible apportionment as concerns multi-jurisdictional, affiliated corporations. Moreover, the Supreme Court's overall treatment of the guiding principles has been described as lacking concreteness by commentators, as well as by the Court itself." *Unisys*, 812 A.2d at 459. This court goes on to note that "[t]he degree to which the [U.S.] Supreme Court intends for external consistency to serve as an additional gauge for theory, as opposed to merely a final check on application of apportionment formulae, is unclear." *Id.* While the Pennsylvania court admitted its confusion, courts in other states have deduced to varying degrees the proper analysis, thus creating

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[6] *See e.g., NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86 (Min. 1989), *cert. den.* 493 U.S. 848 (1989); *NCR Corp. v. South Carolina Tax Commission*, 402 S.E.2d 666 (S.C.1991) and 439 S.E. 2d 254 (S.C. 1993), *cert. den.* 114 S. Ct. 2763 (1994); *NCR Corp. v. Taxation and Revenue Department of the State of New Mexico*, 857 P.2d 788 (N.M. App. Ct. 1993), *cert. den.* 114 S. Ct. 2763 (1994).

inconsistent treatment at the state level of this federal constitutional issue. *See Tambrands, Inc. v. State Tax Assessor*, 595 A.2d 1039 (Me. 1991) (including dividends from subsidiaries in tax base but not the factors that generated those dividends in the apportionment formula violated the Due Process clause regardless of the level of actual distortion in the tax), *American Tel. & Tel. Co. v. Wisconsin Dept. of Revenue*, 422 N.W. 2d 629 (Wis. Ct. App. 1988), *review denied*, 428 N.W.2d 554 (Wis. 1988) (same). When one state supreme court asks for guidance and is in direct conflict with the analyses of other state courts, this Court is the only forum available to fill this void.

Additional clarification by this Court of the scope of the "fair apportionment" requirement is necessary because of the limited forums available to taxpayers to pursue a consistent resolution of the issue. A taxpayer generally cannot challenge the constitutionality of a state or local tax in the lower federal courts. U.S. Const. Amend. XI; 28 U.S.C. § 1341. The Eleventh Amendment[7] prohibits suits for monetary damages against a state in federal court and thus prevents all suits for state tax refunds. *Ford Motor Co. v. Dep't of Treasury of Indiana*, 323 U.S. 459, 462 (1945). The Tax Injunction Act, as interpreted, prohibits taxpayers from bringing any action in federal court if there is a "plain, speedy, or efficient" remedy at state laws. *Newsweek, Inc. v. Florida Dep't of Revenue*, 522 U.S. 422, 444 (1998). Most of the cases interpreting the Tax Injunction Act have determined that state refund or protest systems are plain, speedy, and efficient and thus jurisdiction in the federal courts is generally prohibited. *See, e.g., id.; California v. Grace Brethren Church*, 457 U.S. 393 (1982). Thus, taxpayers are usually limited to a state court as the final arbiter of what constitutes "fair apportionment". To

[7] The Judicial power of the United States shall not be construed to extend to any suit . . . commenced or prosecuted against one of the United States by citizens of another state . . . . " U.S. Amend. XI.

ensure that these state courts provide a constitutionally sufficient analysis and to promote consistency among the states in crafting this analysis, COST and the Chamber respectfully request this Court to accept this case for review to provide such guidance.

II. THE ISSUE OF FAIR APPORTIONMENT IS OF FUNDAMENTAL CONCERN TO BUSINESS TAXPAYERS.

Without a doubt, one of the four most pressing constitutional issues confronted by multistate taxpayers, state revenue departments, and state legislatures is the issue involved in this case as to what is considered a "fairly apportioned" tax. [8] Every state relies to some extent on formulary apportionment to calculate its taxable share of the tax base. While most formulary apportionment systems are both standard and non-controversial, some raise serious questions. For example, several states incorporate a concept of "throwback" in which sales into a state in which the taxpayer is protected from tax are included in the numerator of the state of origin. Some taxpayers consider throwback to fail the fair apportionment prong because it taxes extra-territorial values (the sales into other states). Further, the current economic environment is generating some creative tax ideas by legislators and some novel applications of those laws by the state revenue agencies. Many of these changes involve a change to the tax base and/or the definition of a taxpayer but not a concomitant change to the relevant apportionment formulae. Each of these potential but unresolved problems may be subject to prolonged litigation and taxpayers as well as tax authorities have a significant interest

[8] The other issues are also familiar to this Court – the limits on nexus (or jurisdiction to tax); discrimination against interstate commerce; and appropriate remedies for the imposition of an unconstitutional or otherwise invalid state tax.

in reducing this litigation through clarification of the "fair apportionment" standard. At the very least, a decision in this case by this Court will give some basis for consistent application of the standard in the myriad of potential cases rising up through the various state administrative processes now and in the future.

For this reason, COST and the Chamber find it a crucial time to seek further guidance from this Court on the scope of the fair apportionment prong. It is of fundamental relevance to business taxpayers as they struggle to comply but not be disadvantaged by a rapidly changing tax environment.

III. THE STATE COURT IMPROPERLY BROKE THE CONSTITIUTIONAL LINK BETWEEN APPORTIONMENT AND A UNITARY BUSINESS.

A fundamental concept relied upon again and again by this Court is that "the linchpin of apportionability in the field of state taxation is the unitary business principle." *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980). The unitary business principle defines the scope of the business a state may tax and ignores the geographic and legal limits of such a business. In this case, the taxpayer has stipulated that it and its subsidiaries are part of one unitary business. Pennsylvania requires consolidated reporting of net worth for a taxpayer with investments in other entities and Unisys has raised no object to the consolidation on unitary or other grounds. By failing to first acknowledge the scope of the taxpayer's business activities subject to the Pennsylvania franchise tax, the Pennsylvania court failed to offer support for the only justification for apportioning the values of an interstate business—the unitary nature of that business.[9]

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[9] This is not a case as to whether the state may constitutionally include the subsidiaries at all in the tax base. States retain the ability to choose their tax systems—whether they chose a separate return system, a com-

Once the scope of the business to be apportioned has been defined as unitary, there is no valid excuse for breaking the fundamental link between the unitary business and the means used to apportion such a business.

An example can demonstrate the problems with the Pennsylvania system and the Pennsylvania court's analysis. Suppose that a Pennsylvania taxpayer owns two pieces of property: one located in Pennsylvania and the other located in Connecticut. Each piece of property is worth $100. Assume all of the taxpayer's other factors are equally split between the two states. If the taxpayer owns both parcels outright, the value of the property is included in its tax base and the value is included in its apportionment formula. The resulting tax base is equally split between Pennsylvania and Connecticut. However, if the taxpayer transfers the Connecticut property to a subsidiary, the value of the property is still included in the tax base but will no longer be reflected in the Pennsylvania apportionment formula. Thus, 100% of the taxpayer's property factor will now be in Pennsylvania, thereby increasing the taxpayer's Pennsylvania apportionment percentage, its Pennsylvania tax base, and therefore the ultimate tax. By changing the ownership of the property from the taxpayer to its subsidiary, the taxpayer's tax in Pennsylvania has increased with no fundamental change in its value—the very base the state claims it is taxing. Put another way, if two identical taxpayers have an identical tax base but one owns Connecticut property outright while the other owns the property through subsidiaries, the former will have a lower tax in Pennsylvania than the latter, even though the value of the overall enterprises are identical. The reason for this

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bined reporting system, or a consolidated system such as Pennsylvania is a choice of state law. Once a state chooses a system however, that system must be consistent. Pennsylvania chose a consolidated system to tax the value of a unitary group and that system must be used for the tax base as well as the apportionment factors.

inexplicable result is the inconsistency Pennsylvania creates by defining the tax base under what is at essence a unitary theory but the apportionment factors under a separate legal entity theory. It is this inconsistency that causes the tax difference and this inconsistency that results in the constitutional infirmity.

The Pennsylvania court's error is somewhat understandable. Most of this Court's fair apportionment cases have dealt with an otherwise valid formula's application to a particular set of facts.[10] That is not the issue here. For example, in *Container*, the issue was whether the standard apportionment factor was appropriate for the taxpayer's international business. *Id.* at 180. In that case, the state included the income from both the taxpayer and its affiliates in the tax base and included the apportionment factors from the taxpayer and the affiliates in the apportionment formula. The taxpayer argued that including foreign companies with different profit and wage calculations in the calculation of a domestic tax violated the fair apportionment prong. This Court first noted that the taxpayer was operating a unitary business with its foreign affiliates and that this unitary business was used to determine the tax base *and* the apportionment formula. This Court went on to refuse to invalidate the use of the standard formula in that case because the evidence did "not by itself come close to impeaching the basic rationale behind the three-factor formula." *Id.* at 182. Once the *Container* Court determined that the taxpayer was

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[10] This case is also different than most of this Court's other apportionment cases in that the tax base in this case is the value of the taxpayer, not the net income of the taxpayer. The label that Pennsylvania uses, however, does not negate the practical effect that Pennsylvania is taxing the value of both the parent and its subsidiaries. As this Court once put the matter, a "tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes.'" *Trinova Corp. v. Michigan Dept. of Treasury*, 498 U.S. 358, 374 (1991) (quoting Jenkins, State Taxation of Interstate Commerce, 27 Tenn. L. Rev. 239, 242 (1960)).

part of a unitary business, the statute itself mandated including that unitary business in both the tax base and the apportionment formula. Pennsylvania fails to follow this example and it is there that the problem arises.

This Court should address the inherent mismatch between Pennsylvania's tax base and its apportionment formula. As the linkage between apportionability and the unitary business principle teaches, once Pennsylvania chooses to include a business group in the tax base, it must include that same group in the apportionment formula used to divide that base.

CONCLUSION

For the reasons stated above, and because COST and the Chamber expect this issue to be of continued importance to the state tax community, *amici* respectfully requests the Court to accept this case for review.

Respectively submitted,

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